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TAGS: PREL ETRD ECON EAID EAIR ETTC PTER KTFN UNMIK
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SUBJECT: KOSOVO: KEK PRIVATIZATION REQUIRES RELIABLE
COLLECTIONS SCHEME

Classified By: AMBASSADOR TINA S. KAIDANOW FOR REASONS 1.4 (B) AND (D)

¶1. (C) SUMMARY: The Government of Kosovo (GOK) has publicly announced its commitment to move forward with privatization of the distribution functions of the country's public electric utility, the Kosovo Energy Corporation (KEK). While the pledge to privatize is both significant and necessary, the factors challenging a successful privatization process are considerable. In its current state, KEK is largely overstaffed and inefficient, with aging and sometimes faulty equipment struggling to provide electricity to the country. Collections are low and in some parts of Kosovo, non-existent. Through a long history of non-payment, some households have accumulated thousands of euros of debt. Attempts to regularize customer payments throughout Kosovo and collect arrears have highlighted political and ethnic sensitivities, particularly in minority areas, where local residents are being pressured not to engage with KEK and GOK representatives.

¶2. (C) SUMMARY (cont,d): To make Kosovo's electricity sector attractive to a prospective investor, it is essential that KEK be able to collect payment at cost-recovery levels for power delivered throughout Kosovo. To accomplish that, the GOK and KEK must commit to normalizing collections throughout the country in a manner that does not alienate minorities, and offers a debt relief and repayment plan that is applied equally to all households. Attempts to bring Kosovo Serb enclaves into the regular KEK payment system may push parallel Serbian government representatives to dig in deep, and lead to a further strain on inter-ethnic relations. However, not implementing a uniform and regular payment system throughout Kosovo will perpetuate significant financial losses for KEK, forcing the GOK to contribute more money from the central budget to keep KEK running, while running the very real risk of not attracting any investors for privatization. This could leave Kosovo literally in the dark and broke. A combined aggressive collection and debt repayment scheme applied uniformly across Kosovo could address these problems. However, these actions could also result in increased inter-ethnic tensions, and possible confrontation between representatives of Kosovo and Serbian institutions. END SUMMARY.

KEK: DRAIN ON THE BUDGET

¶3. (SBU) On October 2, the GOK publicly announced plans to move forward with the privatization of KEK's electricity sector, starting with privatization of the company,s distribution network by the end of 2009. We expect the GOK to issue the tender for the multi-billion dollar "Kosovo C" power plant (now known as "New Kosovo") before the end of ¶2008. Selection of a developer should follow by the end of 2009 or early 2010. With the exception of the high-voltage transmission company KOSTT, the completion of these two actions will completely privatize Kosovo's electricity sector by the end of next year, and remove a large resource drain from the government's books. Each year, KEK requires a disproportionately large amount of budget assistance to cover maintenance, equipment purchases and energy imports. Over the past several years, the amount of GOK subsidies to the sector has typically exceeded 100 million euro, due to insufficient company revenues and mismanagement that has left critical equipment purchases and repairs unfunded by the company's own revenues. KEK budget requirements for 2009 are well above the GOK budget projections, around 80.4 million euro for time-sensitive capital investments in maintaining continuous coal production, plus an estimated 70 million euro to cover the cost of imported power. Without the attraction of private capital through the timely completion of the Kosovo C process and privatization of KEK,s distribution functions, KEK,s drain on the GOK state budget will begin to overwhelm all other budget lines.

NON-PAYMENT, COMPOUNDED BY KOSOVO SERB ISSUE

¶4. (SBU) As the GOK privatizes KEK's distribution and seeks to conclude a package for the development of Kosovo C, establishing a normalized and uniform payment system throughout Kosovo is critical. KEK provides service to all areas of Kosovo but is unable to collect effectively from consumers, particularly in the Kosovo Serb enclaves. Throughout Kosovo, KEK estimates that only half of all customers pay their electricity bill regularly. KEK is unable to provide uninterrupted electricity service throughout Kosovo at periods of peak demand due to real network and generation capacity constraints, exacerbated by over-consumption resulting from ineffective price-signals. As a consequence, a power rationing scheme distributes power based on the level of regular payments from a given community or neighborhood. Called the "A-B-C" scheme, communities and neighborhoods with the lowest level of electricity payments are subject to the "C" category, receiving two hours of electricity for every six hours. The most reliable customers fall into the "A" category, and are subjected to minimal load-shedding. Yet during periods of acute shortages, rationing in the "C" category areas is most severe, with an on/off ratio as limited as one hour "on" and five hours "off". During these times, even "A" category customers, service availability drops to four hours "on" and two hours "off".

¶5. (SBU) Except for a handful of commercial businesses and residences, customers in Kosovo Serb enclaves are not registered as KEK customers. KEK has no ability to enter enclave areas to establish service arrangements with residents or to install meters, due to security and political sensitivities. For similar reasons, service to enclaves has not disconnected. In 2007, KEK completed the installation of bulk-level meters at sub-stations serving enclaves. According to KEK, service to the enclaves comprises about 10 percent of overall electricity consumption in Kosovo, a value of 20 million euro per year. Of this 10 percent, the three northern provinces of Zubin Potok, Leposavic and Zvecan, plus Serb-majority north Mitrovica, are the largest consumers. With the exception of the these areas, Serb enclaves in the Albanian-majority south of the country automatically fall into the "C" category of power rationing due to non-payment. This would also happen in the north, but the A-B-C scheme

cannot be applied there due to lack of technical capacity.

¶6. (C) In the process of intensifying efforts to increase payment compliance, KEK is discovering many households have significant amounts outstanding to the utility, sometimes as much as several thousand euro per household. Most Kosovo residents are not in a position to pay this amount. Kosovo Serbs who live in enclave areas are technically "debt-free" because they are not registered as KEK customers and are not receiving bills for consumption. Other Kosovo Serb households, however, and particularly those in ethnically mixed communities (for example in Viti/Vitina municipality) are technically registered as KEK customers where KEK has been able to install meters in that particular community, and have accumulated debt, sometimes to a much larger degree than their Albanian neighbors. In many of these cases, pressure by Serbia's political leadership on Kosovo Serbs not to participate in Kosovo institutions has led these Serb households to avoid payment and thereby accumulate a significant amount of debt. With the ethnic-Albanian Kosovo media picking up on these cases, there have been attempts by Kosovo officials, usually at lower levels, to disconnect Kosovo Serb households in mixed areas. (Comment: Realizing the potential for serious conflict, we have urged officials at the highest levels here to leave the situation as is for the time being. End Comment.) KEK's total outstanding debt is close to 300 million euro, and KEK would undoubtedly benefit from the collection of all its outstanding debt, but it is even more crucial for the energy company to enhance its potential for sale through achieving reliable and regular payments from current electricity customers.

POSSIBLE SOLUTIONS CARRY RISK OF TENSION

¶7. (SBU) Internal discussions with USAID advisors within KEK have identified two obvious but flawed ways KEK could approach this multi-pronged challenge: forgive all past debts and focus solely on current payment discipline, or require immediate repayment of all arrears. Universal debt forgiveness may provoke a backlash from regularly paying customers and inadvertently increase the expectation from non-paying customers that debt forgiveness might be repeated at some point in the future. On the other hand, aggressive collection of all debts regardless of amount or age would place many households in an untenable financial position, as well as leave them facing service disconnection. Neither of these options is feasible.

¶8. (SBU) A hybrid approach establishing a graduated debt repayment program, uniformly applied to all customers receiving electricity service, could be an acceptable and practical solution. Large debts could be scheduled for repayment over 12 months, as is current practice for arrears up to 500 euro, and debts older than one year could be forgiven. This would allow KEK to collect on a portion of arrears and encourage customers to become regular payers, with a minimal amount of debt forgiveness.

¶9. (C) To implement a uniform and reliable collections scheme throughout Kosovo, KEK must be able to establish service agreements with all customers, including with Kosovo Serbs. But KEK's commercial relationship with the Serb community is weak. Regardless of whether Kosovo Serb households are willing to pay for electricity service, KEK is not able to effectively engage this customer base, resulting in mixed and minority areas bearing the brunt of load-shedding as a result of non-payment. For their part, Kosovo Serbs are frustrated at not receiving better service, but are pressured by parallel structure representatives to engage with Serbia,s public electric utility EPS, instead of formalizing arrangements with KEK. Although EPS is not a registered business in Kosovo and does not provide electricity, EPS is active in Kosovo Serb areas, positioning itself as a direct competitor to KEK. The company does have personnel on the

ground connecting Kosovo Serb households to the KEK grid and providing equipment, as needed, to keep the lights on in minority areas. Although the company does not currently do so, EPS does have the capacity to supply electricity directly to northern Kosovo.

¶10. (C) Recent efforts by KEK to intensify collections in Kosovo Albanian areas have revealed that most Kosovo Serb residents in mixed areas have accumulated arrears often several times greater than the amounts owed by Kosovo Albanians in the same community. Although it is important to note that a significant number of Kosovo Albanian households also have large unpaid debts to KEK, Kosovo Serbs tend to feel singled out for non-payment due to poor communications with KEK, and interference from parallel structure representatives reinforces this perception. While KEK insists on engaging directly with Kosovo Serb community representatives, parallel Serbian government representatives tend to insert themselves in the dialogue, preventing any satisfactory agreement from emerging. With any payment collection scheme that is put in place, maximizing the flow of accurate information about changes in KEK's policies toward Kosovo Serb households will be critical for success.

¶11. (C) COMMENT: A reliable and fully operational payment collection scheme is vital to attract investors to Kosovo's electricity sector. No company will accept the obligation to provide service without assurances of being able to reasonably recover costs. Likewise, to the extent that KEK distribution will be the largest single buyer of power generated within Kosovo by the Kosovo C power plant, the project developer will require assurances that KEK distribution will have sufficient revenues to pay for the wholesale power delivered. In essence, the success of the Kosovo C project and KEK distribution privatization rests on

the ability of KEK to collect from its customers. It is critical that payment discipline is achieved, and that KEK's ability to enforce such discipline is credible. Continued poor payment by consumers will have negative effects on potential investors, perception of the Kosovo C project's potential for revenue generation. Pilot projects to install more meters and initiate an aggressive collection policy in certain communities such as Ferizaj/Urosevac have yielded 60 percent increases in collection over the same periods in 2007 in the same areas. KEK believes that intensified collection efforts over the coming six to nine months might allow KEK to collect an additional 70 million euro of past debt owed by households. Such a success might substantially reduce the utility's 2009 request for GOK budget transfers from 150 million euro to 80 million euro.

¶12. (C) COMMENT (cont'd): Once a policy approach to collection of past debts and regularization of service conditions for Kosovo Serb enclaves is adopted, KEK and the GOK's initiatives to implement uniform payment and collection procedures throughout Kosovo will require direct engagement from Kosovo Serbs with the Kosovo's national utility, including in all the enclaves. This could lead to confrontation between representatives of Kosovo and Serbian institutions. USAID advisors within KEK have suggested that while necessary for the sake of privatization, policies writing-off any significant past-due amounts in order to establish universal payment discipline for current and future power consumption might best be postponed until mid-2009. In the interim, KEK would continue to aggressively collect past-due debts from households, but would avoid confrontation with ethnic Serb households.
KAIDANOW